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Abstract: The sharing between national tax authorities of taxpayer-specific information has emerged over the last few years as a—probably ‘the’—central issue in the formation of international tax policy. Yet this refocusing of the debate on international taxation—away from parametric tax coordination and towards strengthening information exchange—has gone largely unnoticed in the public finance literature. This paper gives an overview of this increasingly important area of international taxation, reviewing the key economic, legal and practical concepts and issues bearing on the analysis and implementation of information exchange, and providing an account of recent policy initiatives and emerging theoretical insights.

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I. INTRODUCTION

The exchange of information between national tax authorities has emerged in recent years as a—probably the—central issue in international tax policy discussions. It is at the heart, in particular, of both the controversial ‘harmful tax practices’ project of the OECD (launched in OECD, 1998) and the contentious debates leading to the recent adoption of the savings tax directive by the European Union (EU). This distinct change of focus in international tax policy formation and debate has received relatively little attention, however, in the economic literature on international taxation. The purpose of this paper is to provide an overview of this increasingly important area of international taxation, reviewing the key economic, legal and practical concepts and issues bearing on the analysis and implementation of information exchange, and providing an account of recent policy initiatives and emerging theoretical insights.

The issue to which tax information exchange is addressed is by no means new or unfamiliar, though it continues to grow in importance: advances in technology and the elimination of exchange controls¹ have made it increasingly easy for investors to conceal capital income from their domestic tax authorities by accessing foreign jurisdictions offering low or zero tax rates and failing to report the proceeds to their home authorities.² This undermines implementation of the residence principle, under which income tax is payable to the country in which a taxpayer (whether natural person or company) resides, perhaps with some credit for taxes paid in the source country (meaning that in which the income arises).³ Many countries⁴ formally require taxpayers to disclose details of such income to the tax authorities of their country of residence, but the possibility of intentional mis-declaration is all too evident. These imperfections in enforcement of the residence principle not only directly undermined the intentions of national tax design but, by implying an element of source taxation, created incentives for collectively inefficient tax competition to attract tax base.

Perhaps the most obvious policy response to these problems is to seek an increase in the tax rates imposed by low-tax jurisdictions—although, with the hindsight of the recent focus on

¹ Traditionally, exchange controls were a source of information on cross-border financial transactions.

² This paper focuses on the exchange of information relating to the taxation of capital income. It does not address tax information sharing on indirect taxes, which is less of an issue in a global context, although gaining importance due to the development of electronic commerce and widespread difficulties in controlling VAT refunds on internationally traded commodities.

³ In fact, most countries operate some form of a hybrid residence-source system, with the source country exercising the first right to tax and the residence country then offering a (non-refundable) credit or exemption against its own taxes. Taxation on the basis of the residence principle is in accordance with the model tax convention of the OECD (2000a), which restricts the source country’s taxing rights by imposing limits on non-resident withholding taxes.

⁴ This is true in about half of all OECD members.

information sharing, this is not quite as obviously the best policy as has been presumed. In any event, the possibility of potential gains from tax coordination has been a recurring theme both in the academic literature—with a focus on the potential gains from tax coordination that arises in models such as the classic of Zodrow and Miezowski (1986)—and in practice (with the proposal of a minimum corporate tax rate for the EU by the Ruding Committee (European Commission, 1992). But, as matter of practical politics, coordination of tax rates on capital income has got nowhere:⁵ the implied restriction on national tax sovereignty seems, for many countries, to be simply too much to swallow, both for themselves and also, in some prominent cases, as a matter of principle in terms of what they believe they can properly ask of others. In simply passing information to other countries, however—the argument goes—countries are not giving up any of their national sovereignty in terms of taxing their own residents, but are simply helping others to exercise their sovereignty in taxing their citizens (and receiving a reciprocal benefit in return).⁶ As a matter of principle, moreover, dealing with the underlying informational problems would seem a better-targeted response than a coordination of tax rates. In any event, information sharing may now be the last hope of the residence principle, and perhaps for the taxation of capital income more generally.

This paper is organized as follows. After a review of basic practical concepts and issues in Section II, Section III studies the economics of information sharing. Section IV focuses on some of the legal and practical obstacles that information sharing can encounter, and Section V reviews the main well-established instruments for information transfers. Not surprisingly, countries do not readily reveal the nature and extent of the information that they pass to, and receive from, the tax authorities in other countries, since that information can itself impact investors' behavior. Section VI reviews what is nevertheless known about how information exchange works in practice. Section VII addresses the two major recent policy initiatives—those of the OECD and EU—mentioned above. The links between international tax evasion and money laundering, another area of considerable policy attention in recent years—links that remain imperfectly understood—are considered in Section VIII. The final section concludes.

⁵ This is in contrast to some progress in coordinating rates of indirect taxation, especially within the EU, even though—or perhaps because—the cross-border fiscal externalities from such taxes, though occasionally large, seem likely to be less.

⁶ The counter-argument is that no country should be asked to deal with the problems caused by the dishonesty of residents of other countries.

II. SOME BASICS

This section discusses the nature of the tax information at issue, and some of the practicalities involved in information sharing between national authorities.

Information Sought

The information required to ensure full compliance with residence-based taxation depends on the nature of the tax. For income taxation, it would include: statements of interest and other capital income received (dividends, royalties and rents); information on employment income; ownership structures to identify the final beneficiary of such payments, especially in the case of assets held by fiduciary agents; information on expenditures claimed as deductions in the residence country; and information on payments and on the identities of the beneficiary, settlors and trustees. Information requests may also relate to particular transactions—prices, costs, and commissions—to enable the residence country to determine the tax liability.

Types of Information Exchange

In practice, there are three main types of case-specific information sharing. The most common form is *information exchange upon request*: information is transmitted in response to a specific request from the residence country. The second form is *automatic exchange of information*, where the tax authorities of the source country periodically pass on to the residence country all tax-relevant information they have agreed to exchange.⁷ The third type, *spontaneous information exchange*, is that in which the authorities of one country, on their own initiative, pass on tax information—acquired perhaps in the course of an audit—that they think may be of interest to the tax authorities of another country.

There are other possible forms of information sharing. Countries regularly exchange non-case-specific information; for example, tax authorities may share their auditing experiences in dealing with transfer-pricing issues arising in a particular sector. One could also conceive of sharing information on a random basis, perhaps guided by some kind of risk selection criteria. For practical purposes, however, the discussion below focuses on the three kinds of information sharing distinguished above.

Criminal versus Civil Tax Matters

In the language of the OECD (2002a), criminal tax matters refer to tax investigations involving intentional conduct which is subject to criminal prosecution—typically in the country of residence of the offender. Civil tax matters refer to the determination, assessment, and collection of taxes or non-criminal penalties, or enforcement of a tax liability. The distinction between the two tax matters is relevant because some countries adhere to the

⁷ For example, 11 OECD members automatically exchange information with treaty partners. In rarer instances, information flows from the residence to the source country.

principle of *double incrimination*, meaning they are unable to share information unless the potential offense would also be a tax crime if committed in their own jurisdiction. Where the definitions of tax crimes are similar, this principle will generally not be an impediment to information exchange. Matters are more complicated if countries have different notions of what constitutes a tax crime (see Section IV).

Administrative Aspects

Advances in technology have made transmitting information increasingly easy. Many countries now automatically transmit tax information to others in electronic format. The real issue is whether the receiving country can make full use of this information. Though presumably straightforward for specific requests, matching information received to a country's own records is likely to be far from easy in the absence of a common taxpayer identification number across countries.⁸ Moreover, individuals may be able to mask their residence for tax purposes by providing a false identifier.

As a further source of possible ineffectiveness of information sharing, it is likely (indeed may well be optimal from the national perspective) that domestic demands on tax administrations will be given higher priority than information requests from abroad. This is particularly so when, as in many developing countries, those tax administrations are greatly stretched or the flow of information is essentially one-sided. As a result, information requests from abroad run the risk of ending up 'at the bottom of the pile'—especially if there is no prospect of costs that are incurred in complying with requests being reimbursed by those requesting the information. We return later to the question of strengthening the incentives for source countries to provide information.

Compliance and Cost Issues

Bilateral tax and information exchange treaties constitute binding law, specifying the rights and obligations of the signatory governments, although there is no international body to enforce these agreements. The convention is generally that information exchange is a matter of reciprocity. The type of information exchanged, however, need not be reciprocal in nature. Country A may be interested in information on interest income, whereas country B may want to receive information on dividend income. A lack of reciprocity may reflect a legal obstacle (see Section IV), the absence of taxable activities to report on, or a country's reluctance to cooperate. In the latter case, diplomatic pressure may be exercised. Informally, requesting authorities could also punish non-cooperative treaty partners by refusing any of their future information requests, by delaying the processing of these requests or by not cooperating with them in other areas.

⁸ Some countries do not even have a unique taxpayer identification number for domestic use.

Under the reciprocity principle, an information-supplying jurisdiction usually does not receive any (monetary) compensation for the ordinary costs of doing so, and nor does it receive any share of the additional revenue raised. Extraordinary costs of requests are typically borne by the requesting jurisdiction. In some cases, officials from the requesting country may visit the contracting country to be present during audits and interviews, so bearing part of the costs directly. Also, if domestic banks and financial intermediaries are required to report taxpayers' interest income and transactions to the domestic tax authorities, part of the administrative costs will be borne by third parties.

Confidentiality Aspects

Because of confidentiality laws countries generally cannot provide taxpayer-specific information without a legal instrument (such as an information sharing treaty, see Sections V and VII) permitting such disclosure. To protect confidentiality, legislation typically prescribes that information can only be used for tax purposes, and only be disclosed to authorities (typically including judicial and oversight authorities) concerned with the assessment or collection of taxes covered by the treaty. In some countries—including Germany, the Netherlands, and Sweden—the tax authorities must notify the taxpayer prior to replying to an information request from another country, though this requirement is lifted in cases of tax fraud.

III. THE ECONOMICS OF INFORMATION SHARING

The ultimate purpose of the sharing of information on income received is to strengthen enforcement of the residence principle, which prescribes that companies and individuals pay tax on their income, wherever in the world it arises, at the rate specified by the jurisdiction in which they reside. Widely, though not universally, accepted as a guiding principle in international taxation, the theoretical case for the residence principle (rather than, in particular, the source principle—taxation according to the jurisdiction in which the income arises) rests on the Diamond and Mirrlees (1971) theorem on the desirability of production efficiency. This is the proposition that, under certain conditions, any Pareto-efficient tax structure has the feature that it leaves production decisions undistorted. This means, for instance, that capital earns the same pre-tax rate of return in every jurisdiction (since otherwise it would be possible to increase global output by moving capital from where its marginal return is low to where it is high). Unlike the source principle, the residence principle is consistent with global production efficiency, because the tax system does not discriminate between capital according to where it is located.

The theoretical merits of the residence principle are of interest here only insofar as it is these that underpin the welfare case for information exchange, and in that context two features of the production efficiency argument bear emphasis. The first is that the conditions required for the Diamond-Mirrlees theorem are far from trivial. They include, for instance, the requirement that any pure profits be fully taxed and—as set out in Keen and Wildasin (2004)—even more stringent requirements in international settings (because, loosely

speaking, departures from production efficiency may be needed to ensure that all countries gain from reforms that increase global output). Second, the efficiency argument is silent on whether revenue ultimately accrues to the residence or the source country: what matters for efficiency is uniformity in the tax treatment that investors face on income from different sources, not who they pay the taxes to. Indeed, something like recognition of this is implicit in the current commonplace practice of allowing source taxes as a credit up to the amount of residence-country taxes due: the total liability is then as specified by the residence country, though part (possibly all) of the tax paid actually goes to the source country. As will be seen, however, the importance of this point—the irrelevance, crudely put, of which government gets the money—has not been fully appreciated in discussions of information exchange.

The key theoretical challenges in understanding information sharing itself are simply put: Why might one country choose to provide information to another? Does self-interest lead them to provide the appropriate amount of information? Why is it—as the EU experience has been—that small countries prefer to levy withholding taxes whereas large countries favor information sharing?

Here the starting point is the observation that by providing information to foreign tax authorities a country makes itself less attractive to foreign investors—which can hardly be in its own best interests. Thus, as stressed by Tanzi and Zee (2001) in an early discussion of these issues, it is far from clear that information exchange agreements can be expected to be self-enforcing. The national interest would seem to lie precisely in not sharing information, thereby becoming a relatively more attractive location for investors and so securing some national advantage, whether in terms of tax revenue, banking business, or tourism.⁹ By the same token, there is a presumption that information will be under-supplied in equilibrium. Even if countries could secure mutual benefit from sharing information, the incentive that each faces not to enter such arrangements, or to renege upon them, suggests that there will be too little information supplied.

It may be that some countries choose to provide information, even if apparently against their own interests, because they believe this to be an aspect of international good behavior. A more persuasive analysis of these issues, however, needs to be rooted in self-interested incentives to provide information. The literature has identified three sets of circumstances in which countries may indeed find it in their interest to supply information.

The first situation is that when countries commit to the extent of information exchange prior to their choice of tax rates, the former being seen as akin to a long-term treaty commitment and the latter as a policy decision that is more readily altered. In this case—as first pointed

⁹ In contrast, Eggert and Kolmar (2002) find that countries may voluntarily choose to share information fully, but in their context there is no particular benefit to any country—whether in terms of tax revenue or banking business (the main routes to benefit usually considered in this literature)—from attracting inward investment, so that the basic problem essentially vanishes.

out in the pivotal paper by Bacchetta and Espinosa (1995)—a country may benefit from unilaterally choosing to provide some information¹⁰ to its partner in the first stage of the non-cooperative game. By doing so, it induces its partner to set a higher tax rate in the second stage (because the knowledge that information will be provided to their domestic authorities makes it less attractive for its residents to invest abroad). In this setting, there are thus two effects of information exchange that a country must weigh against each other: (i) an adverse effect at unchanged tax rates; and (ii) a beneficial strategic effect from an induced increase in the tax rate set by the other country. Trading off these two considerations will generally lead a country to voluntarily provide at least some information to its partners. Indeed, Keen (2001), in a somewhat different model,¹¹ finds that the strategic consideration is so strong—abstracting for simplicity, as all these analyses do, from any resource cost involved in collecting and sharing information—that countries will choose to provide full information.

While the strategic effect may induce some unilateral information provision, the possibility of there being, in principle, some mutual gains from an exchange of information also suggests that countries may find some way of enforcing such multilateral cooperation. This is the second possibility—modeled by viewing choices of tax rates and information provision not as a once-only matter but as an infinitely repeated game—that has been explored in the literature, most notably in a later paper by Bacchetta and Espinosa (2000) and by Huizinga and Nielsen (2003). Sustaining such a cooperative exchange of information requires that the attractions to each country of defecting from (or not entering) the agreement—the basic problem noted by Tanzi and Zee (2001)—be balanced by some form of punishment if it does so. This punishment could be in some other area of national life, just as the OECD retained the right to take ‘defensive measures’ against non-cooperative jurisdictions in the context of its harmful tax practices project (described in Section VII.B below). A natural possibility to consider, however, is that in the event of any country defecting from the agreement the other will revert to also behaving non-cooperatively. Thus, each country must balance the gains from continued cooperation on the one hand against, on the other hand, the temporary gain from failing to provide information together with the costs of non-cooperative behavior by the other country (generally, no provision of information at all and more aggressive competition on tax rates) forever after.

This dynamic cost-benefit calculation turns on a number of features of the economic environment. Broadly speaking, the attractions of defection will be greater—and hence cooperative information exchange harder to sustain—the higher are policy-makers’ discount rates (because they will attach less weight to the benefits from continued exchange of information), the more sensitive are capital flows to their effective tax treatment (because the greater will then be the advantages to the capital importing country of not providing

¹⁰ These models characterize the degree of information sharing as the probability that the income of a non-resident will be reported to the tax authorities in their country of residence.

¹¹ The key difference is that in Bacchetta and Espinosa (1995) countries set different rates on residents and non-residents, whereas in Keen (2001) the two are taxed at the same rate.

information), and (for the same reason) the more imbalanced are capital flows. One further clear implication (and a recurring theme in both this and the wider tax competition literature) is that small countries are likely to have least to gain from information exchange: they are inclined to set lower tax rates in order to attract inward investment (the gains from which can swamp the consequences of any revenue lost from the small domestic tax base).

A third way in which countries may be induced to share information is by offering them a carrot rather than a stick. As stressed above, there is nothing inherent in the efficiency rationale for the residence principle requiring that all (or indeed any) of the revenue collected on cross-border investments as a result of information provided by the host country should accrue to the residence country. Thus, there is no intrinsic reason why some of the additional revenue collected as consequence of information exchange should not be transferred to the country that provides it.¹² The incentive effects of such transfers are considered in Keen and Ligthart (2004a,b), dealing respectively with the cases in which countries can and cannot set different rates on residents and non-residents. Two main conclusions emerge. First, the efficiency argument for such revenue sharing proves to be weak, in the sense that—somewhat counter-intuitively—the total amount of revenue raised (across all countries) is actually lower the greater is the proportion of revenue that is allocated to the country that provides the information. The reason for this is that such transfers make inward investment attractive to the host country not only for the tax the investors pay directly to the host but also for the additional revenue that the host government receives in respect of those foreign investors unlucky enough to be caught by the exchange of information. This in turn induces countries to compete more aggressively for such investment by lowering their tax rate, thus providing a further downward twist to mutually damaging international tax competition.

The second conclusion, however, is that the despite this adverse efficiency effect, the distributional effects of such revenue-sharing arrangements on the cross-country allocation of tax revenues may mean that it has a useful role to play in inducing a low-tax country to participate in information sharing. That is, although the high-tax country forgoes revenue in transferring some of the additional revenue it collects from information received, it may nevertheless be in its interest to do so, since this may be more than offset by the advantage it receives by inducing the low-tax country to provide more information than it otherwise would. More precisely, Keen and Ligthart (2004a,b) show that that some transfer of the additional revenue collected as a consequence of information exchange to the country providing that information may be Pareto-improving if the asymmetry in country size—size in their model being what drives the asymmetry in tax rates, the smaller country setting the lower tax rate—is great enough. If the two countries are identical in size, there is no gain from such transfers: both share equally in the efficiency loss induced by lower withholding tax rates. When they are dissimilar enough, however, the high-tax country gains more from

¹² These transfers are above and beyond any financial compensation for extra-ordinary costs incurred in collecting and providing information. Reimbursement of the latter is generally provided for in double taxation relief treaties, as noted above.

the information it receives (and consequent ability to tax its own residents) than it loses from the transfer of revenues.

A subsidiary theme in the literature has been the comparison between the provision of information by source countries and the imposition by them of withholding taxes on income arising to non-residents. This is a natural comparison to make, both because of the similarity between the two instruments as devices to discourage the evasion of domestic taxes by investing abroad and failing to declare the income, and—at a very practical level—because the early discussion of the EU savings tax directive explicitly envisaged enabling member states to choose between the two (and indeed the outcome, described in Section VII below, has member states divided along these lines). The comparison should not be overstated, since there is no reason, either in principle or in practice, why countries should not do both.¹³ Indeed in the two-stage game studied by Keen and Ligthart (2004a,b), both will typically be used in equilibrium, with the potential of a mutual gain relative to the situation in which only one is used. One would, nevertheless, expect the two to be substitutes rather than complements in countries' tax armories: the more inward investment is discouraged by one instrument, the lower one would expect the national gain to be by also discouraging it through the other. Compared to a situation in which only withholding taxes may be deployed, for example, Keen and Ligthart (2004a) show that when information may also be exchanged tax rates will tend to be lower, confirming that the instruments are in that sense substitutes. Interestingly, however, collective revenue is higher when information sharing is used as well as withholding, even though tax rates are then lower. The explanation of this apparent paradox lies in the additional revenue collected on investments revealed to the home tax authorities by the exchange of information; this proves to more than offset the direct loss of revenue from the lower tax rates.

The prediction of substitutability does indeed seem to be borne out in practice. As noted by Gordon and Hines (2002), one reason that double tax treaties provide for reduced withholding taxes on income flows is presumably that the information exchange clauses they also contain tend to offset the scope for evasion that would otherwise be created. And Huizinga and Nicodeme (2004) find that of 440 pair-wise relationships amongst industrialized countries for which they had information only 17—all relating to Australia—involved both information exchange (automatic, in these cases) and non-zero withholding taxes on interest income. The puzzle here is to explain why countries should so completely forego any revenue on cross-border capital flows.

Almost all of the formal models in this area deal with the case in which the world comprises only two countries (an exception being Huizinga and Nielsen (2003), who treat the three-

¹³ Those member states that have agreed to share information under the EU savings tax directive (European Commission, 2003), for instance, explicitly retain the right to impose withholding taxes: Article 16 explicitly provides that for those countries adopting information exchange the directive "...shall not preclude member states from levying withholding taxes...in accordance with their national laws and double tax conventions."

country case as an extension of their main analysis). The importance of the ‘third-country problem’ is nevertheless clear, and widely recognized. Unless all countries are party to information exchange, the gains to any subset from agreeing to exchange information is likely to be reduced to the extent that third countries continue to provide an opportunity to invest without declaring the proceeds. Indeed countries might even make themselves worse off by entering such an agreement: it could be, for example, that the third country will behave even more aggressively because of an enhanced monopoly power in the provision of information-free saving. What makes this problem especially challenging, at least at first sight, is that it is small countries which, for the reasons noted above, have most to gain from remaining outside information sharing agreements—and the world contains a lot of small countries. Thus, of the 35 tax havens with which the OECD’s harmful tax practices project has been concerned (as discussed below), 21 have populations of less than 100,000; and the average size of the seven labeled in 2002 as noncooperative is 550,000. At an analytical level, relatively little is known about the circumstances in which a subset of countries can gain from entering a mutual exchange of information (along the lines of the analysis of the analogous issue in tax competition in Konrad and Schjelderup, 1999). At a more practical level, the potential difficulties of persuading the many small countries to agree to provide information seem obvious: this stands in sharp contrast, for example, to the case of trade negotiations, in which small countries have relatively little power to exert. At the same time, however, it may be that the very smallness of these countries in itself leaves them vulnerable to the suasion of greater powers.

IV. OBSTACLES TO INFORMATION EXCHANGE

To achieve full tax information exchange between national tax authorities three conditions need to be met:

- (i) national tax authorities must have the legal power to share with those of other countries such tax information as they have access to;
- (ii) tax authorities need to have the authority to acquire tax-relevant information from domestic financial institutions and other third parties; and
- (iii) financial institutions and others themselves must possess the complete details of taxpayer-relevant information.

Obstacles to full information exchange can arise at each stage. As noted earlier, some countries can only exchange information related to criminal tax matters (under the principle of *double incrimination*). What makes this an important issue is the wide variation in notions of what constitutes a tax crime.¹⁴ Filing a tax return under self-assessment is mandatory in

¹⁴ All OECD countries have signed the OECD’s Anti-Bribery Convention and passed implementing legislation prohibiting tax deductions for bribes to foreign public officials.

some countries; others may rely on the tax authorities to determine tax liability, and so have a more restrictive definition of tax crime. Recently, all OECD countries, except for Luxembourg and Switzerland, agreed on a common understanding of tax fraud, which is defined to include the intentional violation of a legal requirement concerning the accurate reporting, determination or collection of tax.¹⁵ Second, some countries are not able to share information on matters in which they do not themselves have a tax interest (the *interest test*): this was the case, until recently, in Japan, Ireland, and the United Kingdom. Presently, there is no longer any OECD country that requires a domestic tax interest. Third, bank information may be regarded as a commercial secret and so, depending on the nature of agreements entered into, immune from information sharing. This is the case in Switzerland and Portugal. Nevertheless, most OECD countries can provide bank information to treaty partners on request. Austria, Belgium, Luxembourg, and Switzerland can do so in very limited circumstances (for criminal tax purposes only). In 11 OECD countries bank information is automatically exchanged with treaty partners (OECD, 2003).

Bank secrecy restrictions may allow the tax authorities access to bank information¹⁶ only in relation to criminal tax matters, not civil tax matters. This is the case in a minority of OECD countries. In Switzerland, for example, information can be obtained by the tax authorities only in relation to tax fraud as defined in Swiss legislation (which does not include, for instance, non-declaration of savings income).¹⁷ In Luxembourg, tax authorities do not have direct access to bank information, though the judicial authorities can obtain this in the case of tax fraud. And in Austria, constitutional restrictions prevent the sharing of tax information in relation to civil tax matters. In addition to bank secrecy restrictions, there may be other kinds of legal restrictions that block access to bank information. The German tax authorities cannot seek bank information simply to verify the correct reporting of interest. Tax authorities may have access to bank information only upon request in the case of a specific tax audit, as opposed to automatically. In 19 out of 30 OECD countries, however, there is automatic reporting from banks to the domestic tax authorities (see OECD, 2000b, 2003).

Even if financial institutions are legally able to exchange information, they may not have enough information to associate the details of a particular account or other asset with a particular individual or company. For example, income may have originated from bearer shares or other anonymous financial instruments. Also, in some countries—though no longer within the OECD—it is possible to open anonymous bank accounts (operated by a password

¹⁵ Tax fraud would include, for example, the failure to file an income tax return, the failure to comply with record-keeping duties, the inclusion of false information, the organization of an insolvency situation, and the deliberate submission of false repayment claims (see OECD, 2003).

¹⁶ Information that tax authorities typically request from banks includes information on deposit balances, signature cards (to verify the control of a legal entity) and interest income.

¹⁷ It seems, however, that Switzerland provides a good deal of administrative assistance to foreign authorities in tax fraud cases (for example, if false documents are used to deceive the tax authorities).

or the like). Recently, the Czech Republic, Hungary, and Austria have taken steps to prohibit the use of anonymous accounts. As a further level of difficulty, however, even if the identity of the immediate owner of an asset is known to the financial institution, that of the ultimate beneficiary may not be. This issue arises particularly in connection with trusts, for which the information required for tax purposes may include settlor, beneficiary, and trustee.

V. ESTABLISHED FRAMEWORKS FOR INFORMATION EXCHANGE

There are a large number of legal instruments in place—double taxation treaties, multilateral conventions, and other bilateral agreements outside tax treaties—to provide some authority for information exchange. They have a number of common elements. For instance, they generally prevent *fishing trips* by requiring that all requests have reasonable cause—that is, requests need to be based on evidence that the particular enterprise or individual is evading taxes.¹⁸ This section discusses the various legal frameworks currently in place.¹⁹

A. Bilateral Approaches

The two main instruments under the bilateral approach are double tax treaties and bilateral information exchange treaties. Besides providing relief from double taxation, bilateral double tax treaties also incorporate an information exchange provision, typically based on Article 26 of the model tax convention of the OECD (2000a) or that of the United Nations (1980). The two model tax conventions are broadly similar in substance concerning the information exchange provision.²⁰ Information on direct taxes may be exchanged on request, automatically or spontaneously. Most tax treaties incorporate qualifying provisions relieving countries from furnishing information that:²¹ (i) is not available under their domestic law, or not obtained under their usual administrative procedures, or (ii) discloses business secrets or is contrary to public policy or national legislation.²² The effect of these qualifying provisions is to reduce obligatory exchanges to a ‘least common denominator.’ The OECD’s Committee on Fiscal Affairs, however, has recently revised Article 26 of the OECD model tax

¹⁸ Besides protecting taxpayer privacy, this also serves the purpose of limiting information requests to a level that is manageable.

¹⁹ Tanzi and Zee (1999) and Kahn (2000) provide a detailed overview of the institutional arrangements.

²⁰ There is some difference in language between Article 26 of the United Nations (UN) model and the OECD model. The UN model is not as broad in scope concerning the restrictions on information disclosure and contains more explicit language on the implementation procedures for information sharing.

²¹ Note that these are fairly standard provisions that are incorporated in most information exchange agreements described below.

²² Denmark, however, does not refrain from providing information in cases where it would be contrary to public policy.

convention to prevent domestic tax interest requirements from blocking information sharing between national tax authorities and to change the confidentiality rules so that information can be disclosed to oversight authorities.

Many countries have also entered into bilateral agreements concerned solely with information sharing. These are sometimes intended to strengthen information sharing provisions in existing applicable double taxation treaties (the negotiation of a separate agreement being potentially less burdensome than reopening treaty negotiations). These arrangements often provide for structured exchange programs specifying the type of information to be exchanged, the use of information in criminal investigations, and the sharing of costs. In 1984, the United States entered into its first tax information sharing arrangement with Barbados (with whom it also concluded a double tax treaty in that same year), making this a condition for the granting of Foreign Sales Corporation status²³ to US subsidiaries operating there. As another inducement, US taxpayers could deduct from their income the expenses incurred attending a convention in a jurisdiction party to an agreement as if the convention were held in the United States.²⁴

In other cases, information exchange agreements may be concluded without a double tax treaty also being in place. There is, after all, little point in having a treaty to avoid double taxation with a jurisdiction which—like, for instance, Bermuda or the Cayman Islands—does not impose any income tax; but, for one side at least, there may be great merit in an information exchange agreement. Over the last few years, the United States, in particular, has concluded bilateral arrangements with Aruba, Antigua and Barbuda, Bahamas, British Virgin Islands, Cayman Islands, Guernsey, Isle of Man, Jersey, and the Netherlands Antilles.²⁵ As of mid-2004, the United States had signed tax information exchange treaties with 26 countries (of which 19 are in force); it has double tax agreements with only five of these countries (of which three are in force).²⁶ The recently signed information-sharing arrangements deal with exchange of information on request, and became effective beginning 2004 for criminal tax matters and from 2006 for civil tax matters. Besides income taxes, they typically cover a large array of other taxes including property tax, insurance levies, hotel tax, time-sharing occupancy tax, gaming tax, and so on. Other OECD countries, such as Germany, Ireland, and Spain are in the process of negotiating similar agreements with jurisdictions that have entered commitments under the OECD harmful tax practices project (discussed further below).

²³ This provided for an exemption from US corporation tax.

²⁴ This forms part of the so-called Caribbean Basin Initiative (CBI), which was enacted in 1984. Besides Barbados, 23 other countries participate in the CBI initiative, including Dominica, the Dominican Republic, Grenada, Guyana, Honduras, Jamaica, Saint Lucia, and Trinidad and Tobago.

²⁵ Those information exchange agreements vary substantially in form and substance. Sharpe and others (2002) provide a comparative analysis of the agreements of the United States with the Cayman Islands and British Virgin Islands on the one hand, and with the Bahamas on the other.

²⁶ The others are signed but not yet ratified.

B. Multilateral Approaches

Given the sometimes quite considerable costs of negotiating bilateral agreements, and the potential difficulties posed by the third-country problem raised above, a number of multilateral agreements on information exchange have also been established. Those multilateral approaches have a strong regional focus and typically involve industrialized countries. The average number of participating countries is relatively small—generally less than 25—compared to certain environmental and trade agreements.

The EC Mutual Assistance Directive (1977) provides for the exchange of information on direct taxes and certain indirect taxes (VAT and excises) among authorities of the EU.²⁷ Besides its more extensive coverage of taxes, it also provides for a broader framework of information exchange than do the OECD and UN Conventions in that it also allows for *tax examinations abroad*, meaning that representatives of one member country are allowed to be present and gather information during a tax inspection in the territory of another member state. The EC Mutual Assistance Directive includes provisions promoting timely and effective cooperation between national tax administrations, in that it: (i) requires maximum promptness in the response to a request by explicitly imposing time limits; and (ii) encourages countries to exchange audit experiences and reports.

The Multilateral Convention on Mutual Administrative Assistance in Tax Matters (CMA, 1995) is a joint product of the OECD and the Council of Europe (1988), agreed in 1995 and currently ratified by nine countries: Canada, Denmark, Finland, Iceland, the Netherlands, Norway, Poland, Sweden, and the United States. It applies to a broad array of taxes, covering direct taxes (including capital gains and net wealth taxes) and virtually every form of indirect taxes (but excluding customs duties) levied at both the national and local level. The CMA features all three types of information exchange, tax examinations abroad, and *simultaneous examination of taxpayers*. The latter involves two or more tax authorities coordinating their efforts to examine simultaneously and independently, each on their own territory, taxpayers that are closely affiliated (for example, a parent and subsidiary). During each stage of the examination, information gathered is regularly exchanged. Besides information exchange on taxes, several other forms of assistance—such as the recovery of tax arrears and the delivery of documents—are provided under the CMA.

Various other regional multilateral agreements exist. The 1999 model agreement of CIAT (the Inter-American Center of Tax Administrations) provides a wide scope for tax information exchange between member countries, including all forms of information exchange discussed above. In addition, the CIAT Agreement outlines procedures and formats

²⁷ European Commission (1977), which was extended to value-added taxes in 1979 and to excises in 1992. The directive was further amended in 2003 to cover taxes on insurance premiums. All EU member states have incorporated the 1977 directive in their national legislation.

to be employed in gathering and transmitting information in response to a specific request.²⁸ The signatories to the Agreement have set a timeframe within which the requested authority should respond. Scandinavian countries exchange bank and other information automatically for all kinds of taxes except import duties under the Nordic Convention on Mutual Assistance in Tax Matters, which entered into force in 1991.

C. Other Arrangements Allowing Information Exchange

Besides the instruments discussed above, information exchange can be effected through a number of other legal instruments. Various countries have concluded bilateral mutual assistance agreements, which incorporate an information exchange provision.²⁹ In addition, the domestic laws of some countries (such as Germany and Ireland) include provisions that facilitate information exchange for the purpose of prosecuting criminal offences (including tax offences). A number of OECD countries (Ireland, Switzerland, the United Kingdom, and the United States) have entered into bilateral and multilateral legal assistance treaties, which allow the exchange of information regarding criminal offences, including tax fraud. And many OECD countries have joined the Hague Evidence Convention, which provides for assistance in civil tax matters as well. There are also important links with arrangements for information exchange in relation to anti-money laundering; these are discussed in Section VIII below.

VI. INFORMATION SHARING IN PRACTICE

Very little is known about how the extent, nature or, especially, the effectiveness of international information sharing. Most countries treat information on the extent and use of information sharing with considerable confidentiality. This reticence is no doubt intended to create a healthy uncertainty amongst taxpayers—the perception that information is shared being seen as having a salutary effect in itself. There is indeed some anecdotal evidence of such effects. For instance, after the United States required information reporting of interest income in 1963, reporting of such income increased substantially even though for years the Internal Revenue Service did not match tax returns. Frank (1991) reports a similar experience with the introduction of interest reporting in the Netherlands in 1987. In the longer term, however, one would expect the perception to come to match the reality. It may thus ultimately be that countries will need to provide more information on the effectiveness of their arrangements to exchange information if those arrangements are to have the credibility finally needed for their effectiveness.

²⁸ For example, the time and place for the taking of a testimony and the production of records should be specified, the authenticity of records should be checked, and so on.

²⁹ For example, the Netherlands and Belgium concluded a bilateral mutual assistance agreement in 1997.

A. Cross-Country Studies

This is a short sub-section, because we are aware of only one such study: that of Huizinga and Nicodeme (2004). Their results do not suggest that, even in perception, information sharing has had a significant effect on taxpayers' decisions: they find that while international patterns of bank deposits across 19 industrialized countries in 1999 were significantly affected by tax rates, the existence of provisions for information exchange has no significant effect.

B. Some Country Experiences

The only two countries of which we are aware that do make public data on their information sharing are Sweden and the Netherlands. Even they provide information only on the number and pattern of exchanges and not, for instance, on the tax revenue recovered. The data are nevertheless instructive.

The Netherlands

As of mid 2004, the Netherlands has entered into 77 bilateral double taxation treaties of which 55 are concluded with non-industrialized countries.³⁰ In addition, the Netherlands also participates in various multilateral conventions that serve as a basis for information exchange. Based on a memorandum of understanding, the Netherlands exchanges information automatically with five countries: its direct neighbors (Belgium and Germany), Canada, Denmark, and France. The information exchanged automatically concerns wages and salaries, pension payments, and cultural royalties, but not interest, dividends and industrial royalties.

Table 1 shows the number of cases for which tax information was provided and received by the Netherlands over the period 1993–2001.³¹ Tax information sharing in this period has increased significantly: gross flows grew on average 43 percent a year. The bulk of the increase is due to automatic exchange of information, which—at about 84 percent of gross exchanges—is now by far the most common form. Although the number of exchanges upon request is small, they could of course be important in terms of the size of the underlying liabilities. For spontaneous exchanges of information, the number of exchanges and country coverage³² seem to vary considerably from year to year. Note too that the aggregate information flows changed direction. In 2000–2001, the Netherlands provided more

³⁰ Based on data from the International Bureau of Fiscal Documentation (2004).

³¹ Besides income taxes the data also include exchanges related to inheritance taxes and, to a limited extent, value-added taxes (excluding intra-EU transactions).

³² The country breakdown is not shown in the table.

information than it received (that is, was a net exporter of information), a turnaround from the period 1996–1999 in which it was a net importer of information.³³

In 2001, the Netherlands provided to and/or received information from 39 countries. Of these, 27 were reciprocated and thus constituted bilateral exchanges of information. The correlation coefficient³⁴ between two dummy variables—taking on a value of one if information was provided or received and zero otherwise—was found to be 1.0 for automatic exchanges, 0.59 for exchanges upon request, and 0.49 for spontaneous exchanges, providing evidence of a high degree of reciprocity in tax information exchange.

The Netherlands provided most of the information to countries of the EU (86 percent of total) and supplied a negligible amount to developing countries (Table 2). The three largest recipients of information were: Belgium (48 percent), Germany (28 percent) and Canada (13 percent), of which the former two are neighboring countries. On the information import side, EU countries provided 77 percent of the information, 20 percent came from other industrialized countries and 2 percent from emerging and developing countries (mainly South Korea). The largest information exporting countries were France (38 percent), Denmark (21 percent) and Canada (20 percent). It is noteworthy that the Netherlands received only a few spontaneous information transfers from Australia, New Zealand, and the United States in 2001—countries with a large share of Dutch migrants—whereas in the previous year 26 percent of the information received in this category came from those countries. A similar pattern was observed for other years, suggesting that spontaneous exchanges with those countries are infrequent and lumpy in nature. It is also striking that there were no case-specific requests made by Aruba—a former colony of the Netherlands—but about 30 requests were received from the Netherlands Antilles.

Sweden

Sweden has 80 bilateral double taxation treaties by January 2004 of which all, except that with Switzerland, have an exchange of information provision. Compared with the Netherlands, Sweden has a more developed network of countries with which it exchanges information on an automatic basis; 19 against five. In 2000, Sweden provided information to 25 countries, relating to 219,000 cases; data on tax information received are incomplete. Table 3 shows that almost all information is provided on an automatic basis, growing by 14 percent over the period 1997–2000. Exchanges upon request are relatively small—a gross flow of 410 cases—and are based on reciprocity as evidenced by the high correlation coefficient (that is, 0.92) between the two information-sharing dummies.

³³ It is not clear what caused this change in the information-sharing pattern.

³⁴ Based on the full sample of treaty countries.

In 2000, the three largest providers of information to Sweden were:³⁵ Finland (20 percent), Norway (20 percent), and Denmark (16 percent). The first two are direct neighbors, and the last a close neighbor with strong cultural ties to Sweden. The three largest recipients of information from Sweden were Finland (20 percent), United States (19 percent) and Norway (18 percent). The proportion of information that Sweden exchanges with its direct neighbors is lower than in the Netherlands (Table 4), reflecting its information exchange network with the Baltic countries and frequent exchanges with countries to which a lot of Swedish workers have migrated such as Canada, New Zealand, and the United States. Similar to the case of the Netherlands, information exchange with developing countries is small—even though Sweden has bilateral tax treaties with 62 of them—suggesting that the level of development of a country and physical distance between countries play a role as determinants of information sharing.

Some Lessons Learned

Although one cannot generalize on the basis of just two countries, a number of tentative lessons emerge. First, information exchange has gone up dramatically in recent years, primarily reflecting the implementation of bilateral automatic exchanges of information. The second lesson is that there is a substantial amount of reciprocity in information sharing, mostly between EU countries.³⁶ Third, the pattern that informally emerges is that information exchanges are more frequent between direct neighboring countries, most likely reflecting cross-border traffic of labor. In addition, countries with many migrants seem to exchange information with their countries of origin. Other potential determinants that may positively affect the amount of information exchanged are: (i) the presence of a common language; (ii) the size of bilateral capital flows; (iii) the level of development of a country (and its tax administration); (iv) the presence of a worldwide tax regime rather than a territorial regime; and (v) the presence of multilateral tax treaties in addition to bilateral tax treaties. Further empirical work—which requires more data—is needed to ascertain the significance of these variables.

VII. RECENT INITIATIVES

Enhancing national obligations to share tax information across borders has been at the heart of the two most important international tax initiatives of recent years: the EU savings directive, and the OECD's harmful tax practices project. Not surprisingly, given the diversity of national interests suggested by the theoretical work described above, each has proved contentious and politically difficult.

³⁵ This excludes data on automatic exchanges, but does include spontaneous exchanges or information sharing on request.

³⁶ This result extends to other taxes as well. Ligthart (2004) finds—while controlling for the size of trade flows—a substantial amount of reciprocity in information sharing for VAT purposes.

A. EU Savings Tax Directive

In January 2003, after more than a decade of discussion,³⁷ the EU Council of Economic and Finance ministers (ECOFIN) reached political agreement on the draft savings tax directive, which was formally adopted in June 2003. The directive is intended to take effect on July 1, 2005, six months later than originally planned. The agreement envisages that all 25-member states will ultimately exchange tax information automatically to all other member states on the interest paid on savings to residents of those other member states.³⁸ It covers EU residents' interest income from debt-claims of every kind including savings deposits, corporate and government bonds, other negotiable debt securities and income from investment funds (as long as the portfolio share of bonds exceeds 40 percent). The directive does not apply to interest income of enterprises. The tax authorities will collect information on interest income from the domestic paying agents; typically, commercial banks, which would not receive any compensation for this.

During a transitional period Austria, Belgium and Luxembourg will instead levy a withholding tax; at a rate of 15 percent during the first three years, 20 percent starting in January 2008, and 35 percent from January 2011 onwards. Member states operating a withholding tax would transfer 75 percent of the revenue from this tax to the investor's country of residence.³⁹ Besides being able to keep 25 percent of the revenues from presently untaxed capital income, these countries would receive valuable information from EU partner countries on their residents' cross-border savings income.

A striking feature of the negotiations towards the directive has been the centrality of attempts to deal with the third-country problem. To mitigate the risk that savings taxation in the EU will divert savings deposits and other interest-bearing investments outside the EU, the European Commission has negotiated *equivalent measures* with six non-EU member

³⁷ The EU savings taxation debate has a long history, dating back to the late 1980s. The 2003 directive (European Commission, 2003) modified the 2001 draft savings tax directive (European Commission, 2001)—also known as the Feira agreement of June 2000—which replaced the 1998 draft directive (European Commission, 1998), allowing each member state to choose between applying either a nonresident withholding tax at a minimum rate of 20 percent or providing information (the so-called coexistence model). This proposal, however, failed to be accepted unanimously—in particular, the UK government opposed it—because of its adverse repercussions for the functioning of the European financial sector. The 1998 proposal, on its turn, replaced a 1989 draft directive (European Commission, 1989), which envisaged a common minimum withholding tax of 15 percent on interest payments made to EU residents. The proposal was heavily criticized for the failure not to take into account outside tax havens, the incomplete coverage of the withholding tax, and its potentially adverse effects on the Eurobond market.

³⁸ New member states that joined the EU on May 1, 2004 are thus expected to share information as of July 1, 2005.

³⁹ To avoid double taxation, the residence country would be obliged to provide a credit for withholding taxes paid in the source country.

countries (Andorra, Liechtenstein, Monaco, San Marino, Switzerland, and the United States). A key issue in the negotiations was the meaning placed on equivalent measures: Switzerland, in particular, made clear early on in the negotiations its view that a 35 percent withholding tax on non-resident savings income—currently also applying to Swiss residents’ savings income—should be accepted as in this sense equivalent, even though the EU views withholding taxes as only a temporary measure. Switzerland also made its participation conditional on Austria, Belgium and Luxembourg agreeing to levy the same withholding tax rates.

Ultimately, the ECOFIN concluded an agreement with Switzerland which stipulates that:⁴⁰ (i) Switzerland will levy a non-resident withholding tax at the same rate as Austria, Belgium, and Luxembourg and will apply the same revenue-sharing arrangement as these three countries;⁴¹ (ii) Switzerland would not need to withhold non-resident tax if the beneficial owner of savings income authorizes the Swiss authorities to exchange information; (iii) Switzerland will exchange information on request—in line with the OECD (2002a) model treaty on information exchange discussed below—in relation to cases of tax fraud and the like as defined under Swiss law; and (iv) parties would consult each other at least every three years with a view to improve the technical functioning of the agreement. Subsequently, Liechtenstein, Monaco, Andorra, and San Marino committed themselves to introduce a withholding tax at the same rate schedule as Switzerland.

Discussions with dependent and associated territories of the Netherlands and United Kingdom—that is, Channel Islands, Isle of Man, and territories in the Caribbean—were held to promote the adoption there of similar measures. They have to either exchange information automatically or levy a non-resident withholding tax during the transitional period. Aruba, Anguilla, the Cayman Islands and Montserrat have chosen to share information whereas the remaining six territories⁴² have committed to impose a withholding tax. It is understood that if Austria, Belgium, and Luxembourg switch from withholding taxation to information sharing all associated territories will follow suit.

The EU Council decided too that the United States had effectively satisfied the condition of equivalent measures given that it already exchanges information (on request and spontaneously) with many EU countries through its wide network of bilateral tax treaties.⁴³

⁴⁰ Scoon and Carter (2003) provide a detailed analysis of the agreement with Switzerland.

⁴¹ The 35 percent withholding tax rate will remain also if these countries adopt exchange of information on request.

⁴² Jurisdictions that impose a withholding tax are: British Virgin Islands, Jersey, Guernsey, Island of Man, Netherlands Antilles and Turks and Caicos Island.

⁴³ The United States does not currently require banks to report interest paid to non-residents (other than Canadians). A long-standing proposal to introduce such a requirement continues to create controversy.

Reaching agreement with these third parties did not prove easy—not surprisingly, given that their interests were in many cases less than fully aligned with those of EU members. The provisions of the savings tax directive will take effect from July 1, 2005—rather than on the envisaged date of January 1, 2005—because it was not until end June 2004 that the EU Council decided that agreement has been reached with all third countries on all matters of substance.

Compared with existing legislation, the savings tax directive presents a more comprehensive system of information sharing in the savings taxation area than established agreements. It includes common rules concerning the details of the information to be reported (on the taxpayer and on the interest earned), the frequency of information exchanges (periodic, at least once a year) and mechanism of information exchange (automatic rather than upon request). Furthermore, the directive makes it more difficult for member states to refuse an information request as it does not include the typical language on limitations to information disclosure as is included in double tax treaties. Finally, it provides for broad country coverage by requiring measures to be taken in key non-EU countries and in associated territories of member states. Nevertheless, the country coverage of the agreement is far from complete. A large number of key financial centers—particularly those in Asia, such as Hong Kong, Japan, and Singapore—are not covered.

B. The OECD Harmful Tax Practices Project

Information exchange has emerged as a central concern of the OECD’s harmful tax practices project. Launched in 1998 (with Luxembourg and Switzerland abstaining from the outset), this began by identifying, in 2000, 35 tax havens for further analysis and dialogue.⁴⁴ Listed in Table 5, these were selected as jurisdictions having low or zero effective tax rates (a necessary condition for listing, but not a sufficient one) and characterized by any of three features then taken to be potentially harmful: lack of transparency, ineffective information exchange and a third criterion related to the provision of benefits *ring-fenced* in the sense of being limited to activities outside the domestic economy and not requiring any substantial activity in the jurisdiction.⁴⁵ In 2001 however (following the change of administration in the US), the last of these criteria was removed, so that the project has come to focus entirely on transparency and information exchange.

Listed jurisdictions found by the OECD to have harmful practices in place were asked to enter commitments to put in place effective information exchange and transparency by January 2006. In April 2002, the OECD published a blacklist of seven noncooperative tax havens not willing to enter such commitments, against which OECD members had reserved

⁴⁴ A broadly parallel exercise has been undertaken with respect to tax regimes in OECD countries.

⁴⁵ The last criteria generated a small literature on the question of whether ring-fencing might actually make tax competition less damaging: Keen (2002) showed the answer to be ‘yes’ in a very simple model; the more general analysis by Janeba and Smart (2003) reached a more nuanced conclusion.

the right to undertake *defensive measures*.⁴⁶ These were Andorra, Liechtenstein, Marshall Islands, Monaco, Liberia, Nauru and Vanuatu; the last two, however, were removed from the list in 2003.⁴⁷ Three of the five remaining noncooperative jurisdictions, it is interesting to note—Andorra, Liechtenstein and Monaco—feature on the EU’s list of third countries with which it has negotiated equivalent measures under the savings tax directive.

To support its work on harmful tax practices, the OECD (2002a) released a model treaty for tax information exchange, both on a multilateral and bilateral basis.⁴⁸ The multilateral instrument provides for an ‘integrated bundle of bilateral treaties’ in the sense that specific parties are only bound by the multilateral agreement if they have explicitly mutually identified each other. Contrary to the EU savings tax directive, which focuses on automatic information exchange, the OECD instrument primarily deals with information exchange on request.⁴⁹ It applies to whatever taxes signatories agree, and so differs from the EU initiative in encompassing more than interest income. With effect from January 2004, each jurisdiction is to have adopted any domestic legislation needed to give effect to effective exchange of information for criminal tax matters. After January 2006, information exchange with respect to both civil and criminal tax matters will enter into force. Various tax information exchange treaties based on this model agreement have been signed or are being negotiated, but none is yet effective.

The information the requested tax authority needs to provide includes information held by commercial banks—thus bank secrecy obstacles have to be lifted—on beneficial owners of companies, settlors, and trustees of trusts. Even if the requested party does not have an interest in the requested information of its own, it is required to gather such information. The requested party, however, is not obliged to disclose any commercial secrets or to provide

⁴⁶ These could include, amongst others, the extension and more aggressive application of controlled foreign corporation (CFC) legislation (enabling passive income to be taxed even if not repatriated), the denial of foreign tax credits and participation exemptions, the imposition of withholding taxes and charges on transactions involving uncooperative jurisdictions and non-tax measures. See OECD (2004) for a complete list of defensive measures.

⁴⁷ Vanuatu and Nauru were removed from the OECD’s list of noncooperative tax havens in May 2003 and December 2003, respectively.

⁴⁸ The OECD model is developed by the OECD’s Working Group on Effective Exchange of Information, which forms part of the Global Forum on Taxation, including representatives from several OECD countries and 11 non-OECD countries. The stated purpose of the Global Forum on Taxation is to achieve a global level playing field based on transparency and a common standard for the effective exchange of tax information. Luxembourg and Switzerland have abstained from the project, and hence also from the development of the instrument described here.

⁴⁹ The OECD model also allows for tax examinations abroad. In terms of information types, however, the OECD instrument, with its focus only on information exchange upon request, offers a smaller menu of types of information exchange than do double tax treaties (which also allow for automatic and spontaneous information sharing).

information that is not available under the normal administrative practices. In that sense, the OECD instrument is more restrictive than the EU savings tax directive. The costs incurred in providing information are to be shared between the contracting parties on a case-by-case basis.

VIII. LINKS WITH MONEY LAUNDERING

While the precise legal definition of money laundering varies across countries, the essence is the undertaking of transactions in order to disguise the true source of illegally acquired funds.⁵⁰ In principle, money laundering and tax evasion are conceptually quite distinct. There can be tax evasion without money laundering; no attempt being made to hide the nature of some income, but only its existence. And there can be money laundering without tax evasion, as when income from some criminal activity is laundered into some legal but taxable form (indeed payment of tax may lend a useful appearance of legitimacy to these funds). There are, nevertheless, important links between the two. Those who wish to spend the proceeds of tax evasion without drawing attention to that possibility of that evasion have an interest in laundering them so that they appear to arise from legitimate sources, with a further decision then as to whether these sources should be tax exempt (foreign bank loans or perhaps, depending on local rules, gambling proceeds, gifts, or inheritances) or taxable. More generally, both tax evasion and money laundering entail some form of concealment of income. In uncovering the ultimate source and routing of moneys, anti-money-laundering investigations may also uncover tax evasion. Indeed as a general rule income even from criminal activities is normally taxable, so that concealing criminal receipts also means evading tax.

There is almost no formal literature on the determinants of money laundering and its links with tax evasion. Yaniv (1994) examines the choice, alluded to above, between misrepresenting illegally-acquired funds as taxable or exempt, which turns on the relative transactions costs involved and the comparative risks of discovery and related penalties. In a later paper, Yaniv (1999) shows that the possibility of money laundering—modeled as a way of making it especially difficult for the authorities to discover undeclared income—tends to increase the extent of tax evasion. Other aspects of money laundering have as yet received little attention—such as the incentives that jurisdictions may have to facilitate money laundering. Low tax rates, however, may clearly make a jurisdiction attractive as a conduit for laundering activities. It is this that gives rise to the links between international information exchange for tax purposes and anti-money-laundering initiatives.

⁵⁰ The Financial Action Task Force (see below) defines money laundering as ‘the processing of criminal proceeds to disguise their illegal origin.’

In response to increasing concerns over money laundering, the Financial Action Task Force (FATF)⁵¹ was established in 1989 to develop a coordinated international policy response. The work of the FATF began with the enunciation of 40 recommendations, the intention being that these should represent minimum standards for incorporation into national laws. In similar fashion to the OECD harmful tax practices project, the FATF has arrived at a list of jurisdictions that it deems non-cooperative in respect of money-laundering standards. None of the original ‘FATF 40’⁵² recommendations, however, addressed money laundering as an adjunct to tax evasion. Importantly for present purposes, however, the 2003 revision to the FATF 40 now provides a minimum range of predicate crimes for money laundering (acts that is, concealing the proceeds from which are subject to anti-money laundering legislation) that explicitly includes fraud—and hence should extend also to tax fraud (FATF, 2003). Recall, however, that, as discussed in Section IV, countries differ in what they regard as a tax fraud.⁵³ By 2002, money-laundering regulations covered tax-related crimes in more than half of the OECD countries (See OECD, 2002b). In light of the revised FATF 40, the EU plans to amend the money-laundering directive.⁵⁴

From the tax perspective, a key question is whether information collected in the course of anti-money laundering investigations can be passed to tax authorities, both domestically and between countries. Recent developments, supported by a commitment of the G-7 finance ministers in May 1998, have sought to make this easier. In particular, the revised FATF 40 requires countries to assist money-laundering investigations from abroad even if they relate only to fiscal matters. Again, however, country practices are still mixed. If tax authorities have received information related to criminal tax matters from domestic anti-money laundering authorities,⁵⁵ this can usually be shared through the country’s network of tax treaties. In some countries, however—including Austria, the Czech Republic, France, Italy, Japan, Luxembourg, Mexico, and Turkey (OECD, 2002b)—domestic fiscal authorities do not have access to the information from anti-money-laundering authorities and therefore cannot pass it on to foreign tax authorities. In others, such as the Slovak Republic, even if the

⁵¹ Now with 31 member countries (the OECD excluding Czech Republic, Hungary, Korea, Poland and Slovak Republic plus Argentina, Brazil, Hong Kong, China, Russian Federation, Singapore, and South Africa) and two member regional organizations (the European Commission and the Gulf Cooperation Council).

⁵² A further eight recommendations to address the financing of terrorism were added in October 2001.

⁵³ Tax evasion is generally considered a crime in its own right—subjecting offenders to fines and in certain cases imprisoning them—in almost all countries. Switzerland is a notable exception.

⁵⁴ The aims of the draft third directive on money-laundering directive (see European Commission, 2004) are to consolidate the first and second directive and to make the necessary amendments to take into account the June 2004 revision of the FATF 40. For example, it expands the range of predicate offences in the definition of money laundering.

⁵⁵ Alternatively, tax authorities and anti-money laundering authorities may engage in joint investigations, which is feasible in many OECD countries.

domestic tax authorities receive this information they cannot share it with foreign tax authorities.

The common feature of concealment means that the informational requirements of action against money laundering are very similar to those required to deal with tax evasion. Each requires, in particular, that financial institutions be able to identify those customers and beneficial owners of an account with whom they are dealing. This gives rise to clear synergies between the two policy areas. In particular, pursuit of such ‘know-your-customer’ rules in anti-money laundering activities—precluding, for instance, the use of anonymous bank accounts—directly reduces the third of the potential obstacles to tax information sharing noted in Section IV. Almost half of the OECD members require taxpayer identification numbers to be provided when bank accounts are opened.⁵⁶ In addition, financial institutions are required to report all suspected transactions for anti-money-laundering purposes even when such transactions are believed to relate to tax crimes.⁵⁷

The distinction between tax evasion (let alone avoidance) and money laundering means that, despite what seems to be a common perception, tax havens are not necessarily centers of money laundering, or conversely. Assessing the overlap between the two types of jurisdiction is not easy, given the natural lack of data on money-laundering activities. However, the various lists of jurisdictions compiled by the OECD and FATF⁵⁸ provide some indication. Table 5 shows that from the 15 countries on the original (June 2000) FATF list of non-cooperative countries, 10 also appear on the original (June 2000) OECD list of tax havens, suggesting significant overlap initially. Alworth and Masciandaro (2003) find, however, that the underlying characteristics of the OECD-listed offshore financial centers and those with low compliance with FATF criteria differ quite significantly. They find that the factors which are statistically associated with a lax regulatory environment—such as scant physical resources, dependence on foreign deposits, and the absence of terrorism and organized crime—are not significant determinants of being a listed tax haven. Moreover, none of the six countries on the revised (July 2004) FATF list is also on the OECD’s final list of six non-cooperative jurisdictions. Perhaps this is not as surprising as it might have seemed at the outset of these projects: those looking for tax havens are concerned that their funds be secure, and so are likely to find politically stable jurisdictions with good governance more attractive, all else equal. The links between money laundering and the facilitation of tax evasion/avoidance thus appear to be more complex than was thought a few years ago.

⁵⁶ See OECD (2000b). Note that the preliminary draft of the amended anti-money laundering directive (see European Commission, 2004) specifies more detailed and specific procedures relating to the identification and verification of the beneficial owner of accounts.

⁵⁷ About half of the countries have defined what constitutes a suspicious transaction (see OECD, 2002b).

⁵⁸ To identify non-cooperative countries or territories, the FATF has identified 25 criteria, primarily relating to the transparency of the financial system and to the degree of law enforcement of a country. The FATF has published an annual report on non-cooperative countries or territories since June 2000.

IX. CONCLUDING REMARKS

The rise of information sharing to a position of such prominence in international tax policy formation can be seen as simply the most notable example of a more general trend (starting to be seen also in relation to indirect taxes),⁵⁹ away from a focus on coordinating tax rates or bases of taxation or both—which has foundered on the concern of key countries to preserve their national tax sovereignty—and toward, instead, essentially administrative measures of cooperation.⁶⁰ In principle, information sharing can serve as a substitute for—indeed may even have less distortionary effects than—coordination of tax systems: with full enforcement of the residence principle, the adverse effects of tax competition would be muted. It is clear from the review here, however, that there are considerable obstacles to be overcome if information sharing is to have as powerful an effect on international taxation as its advocates would wish.

One set of problems is essentially political: ensuring that countries put into place effective mechanisms for collecting and exchanging information sought by others. As we have seen, sharing information is not necessarily in a country's own best interests—and in some cases these economic incentives are reinforced by potential concerns, for historical reasons, with the potential misuse of tax information. In many respects, the OECD and EU initiatives have been extremely successful in achieving quite widespread commitments to effective information sharing. Nevertheless, it is clear that a number of countries—notably Switzerland and Luxembourg—are reluctant to commit themselves to information sharing of the kind that others seek. The politics of this continue to unfold, but at least for the present, the third-country problem remains a very real one. It is perhaps surprising that innovative revenue-sharing arrangements of the kind discussed in Section III—passing some of the additional revenue collected as a consequence of information shared to the jurisdiction that provided it—have not played any role in seeking to resolve the problem.

The second set of difficulties is essentially practical: that of how to make effective use of information that is or could be received. It seems clear that, in the past, much of the information that tax authorities have received automatically from others has gone essentially unused. Finding ways to utilize the mass of information received under automatic sharing agreements is a significant technical challenge. In frameworks enabling the provision of information on request, the key challenge would seem to be to develop audit selection methods that have the appropriate disciplining effects on taxpayers whilst still meeting the

⁵⁹ In the EU, for example, proposals to deal with the distortions and risk of fraud associated with the zero-rating of intra-Union exports by coordinating tax rates have stalled, and the emphasis shifted to addressing them by enhanced administrative cooperation between national tax authorities.

⁶⁰ In the area of indirect taxation, for instance, a key issue within the EU is the continued scope for fraud associated with the zero rating of exports between EU member states. Proposals to deal with this by charging VAT at a uniform rate on all sales within the EU appear to have foundered, however.

‘no fishing trip’ requirement. Not least, ways will need to be found to make it clear to taxpayers that information is not only shared, but also used effectively. This may require rather more transparency in these matters than is normal at present.

Considerable progress has been made in extending the scope of international sharing of tax information, and more is in prospect. The question remains, however, whether that information sharing will eliminate the case that many have seen for some coordination of underlying tax systems themselves.

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Table 1. The Netherlands: International Tax Information Exchange, 1993–2001 1/ 2/

	1993	1994	1995	1996	1997	1998	1999	2000	2001
Information provided	15,352	7,556	8,180	25,967	41,928	25,413	41,984	152,560	106,128
Spontaneous	15,250	7,473	8,044	25,747	22,033	11,576	22,033	13,880	16,434
Automatic 3/	0	0	0	0	19,473	13,436	19,473	138,175	89,083
On request	102	83	136	220	422	401	478	505	611
Information received	24,871	11,649	29,663	7,473	60,169	55,988	60,655	96,343	43,752
Spontaneous	24,790	11,583	29,581	7,316	49,631	32,391	11,204	37,150	5,700
Automatic 3/	0	0	0	0	10,047	22,632	48,115	57,632	36,397
On request	81	66	82	157	491	965	1,336	1,561	1,655

Source: Dutch Ministry of Finance.

1/ Exchanges of information on direct taxes, registration and inheritance tax and VAT (excluding intra-community transactions and customs). Data refer to the number of taxpayers.

2/ Number of cases.

3/ No automatic exchange of information until 1996.

Table 2. The Netherlands: International Tax Information Exchange by Region, 2001 1/

	Information Provided				Information Received			
	Spontaneous	Automatic	Specific	Total	Spontaneous	Automatic	Specific	Total
Total	15.5	83.9	0.6	100.0	13.0	83.2	3.8	100.0
Industrial countries	15.5	83.9	0.5	99.9	10.9	83.2	3.7	97.8
EU countries	15.5	70.5	0.5	86.5	10.8	62.9	3.7	77.5
Direct neighbors 2/	12.4	63.4	0.2	76.0	5.4	4.2	1.9	11.4
Other	3.1	7.1	0.3	10.4	5.5	58.8	1.8	66.1
Other	0.0	13.4	0.0	13.5	0.1	20.3	0.0	20.4
Developing countries 3/	0.0	0.0	0.1	0.1	2.1	0.0	0.1	2.2
Africa	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Asia	0.0	0.0	0.0	0.0	2.1	0.0	0.0	2.1
Europe	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1
Middle East	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Western Hemisphere	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Source: Dutch Ministry of Finance.

1/ Exchanges of information on direct taxes, registration and inheritance tax and value-added tax (excluding intra-community transactions and customs).
Data refer to the number of taxpayers.

2/ Belgium and Germany.

3/ Classification based on the IMF's International Financial Statistics.

Table 3. Sweden: International Tax Information Exchange, 1993–2000 1/

	1993	1994	1995	1996	1997	1998	1999	2000
Information provided	217	280	452	414	147,825	164,546	182,263	219,311
Spontaneous	128	140	219	205	207	233	221	168
Automatic					147,422	164,104	181,862	218,921
On request	89	140	233	209	196	209	180	222
Information received	201	253	356	472	478	444	317	420
Spontaneous	102	154	211	300	325	290	173	232
Automatic 2/					n.a.	n.a.	n.a.	n.a.
On request	99	99	145	172	153	154	144	188

Source: National Tax Board of Sweden.

1/ Exchanges of information on direct taxes. Data refer to the number of cases (that is, taxpayers).

2/ No data available.

Table 4. Sweden: International Tax Information Exchange by Region, 2000 1/

	Information Provided				Information Received			
	Spontaneous	Automatic	Specific	Total	Spontaneous	Automatic	Specific	Total
Total	0.1	99.8	0.1	100.0	n.a.	n.a.	n.a.	100.0
Industrial countries	0.1	98.6	0.1	98.8	n.a.	n.a.	n.a.	80.7
EU countries plus Norway	0.1	74.5	0.1	74.7	n.a.	n.a.	n.a.	66.8
Direct neighbors 2/	0.0	36.9	0.0	37.0	n.a.	n.a.	n.a.	21.5
Other	0.0	37.6	0.0	37.7	n.a.	n.a.	n.a.	45.3
Other	0.0	24.1	0.0	24.1	n.a.	n.a.	n.a.	13.8
Developing countries 3/	0.0	1.2	0.0	1.2	n.a.	n.a.	n.a.	14.1
Africa	0.0	0.0	0.0	0.0	n.a.	n.a.	n.a.	0.0
Asia	0.0	0.0	0.0	0.0	n.a.	n.a.	n.a.	0.0
Europe	0.0	1.2	0.0	1.2	n.a.	n.a.	n.a.	12.4
Middle East	0.0	0.0	0.0	0.0	n.a.	n.a.	n.a.	0.0
Western Hemisphere	0.0	0.0	0.0	0.0	n.a.	n.a.	n.a.	1.7

Source: National Tax Board of Sweden.

1/ Exchanges of information on direct taxes. Data refer the number of cases/taxpayers.

2/ Norway and Finland.

3/ Classification based on the IMF's International Financial Statistics.

Table 5. Listing of Jurisdictions by the FSF, FATF, and the OECD, July 2004

Jurisdictions						OECD		IMF		
	FSF 1/			FATF 2/		List of	Uncooperative			
	Group I	Group II	Group III	(June 2000)	(July 2004)	Tax havens (June 2000)	Jurisdictions (December 2003)	Members on own rights	Dependencies and territories	Non- members
FSF list of offshore financial centers										
Andorra		X				X	X			X
Anguilla			X			X			X	
Antigua and Barbuda			X			X		X		
Aruba			X			X			X	
Bahamas			X	X		X		X		
Bahrain		X				X		X		
Barbados		X				X		X		
Belize			X			X		X		
Bermuda		X				3/			X	
British Virgin Islands			X			X			X	
Cayman Islands			X	X		3/			X	
Cook Islands			X	X	X	X				X
Costa Rica			X					X		
Cyprus			X			3/		X		
Dublin (Ireland)	X							X		
Gibraltar		X				X			X	
Guernsey 5/	X					X			X	
Hong Kong, SAR	X								X	
Isle of Man	X					X 4/			X	
Jersey	X					X			X	
Labuan (Malaysia)		X						X		
Lebanon			X	X				X		
Liechtenstein			X	X		X	X			X

Jurisdictions	OECD									
	FSF 1/			FATF 2/		List of	Uncooperative	IMF		
	Group I	Group II	Group III	(June 2000)	(July 2004)	Tax havens (June 2000)	Jurisdictions (December 2003)	Members on own rights	Dependencies and territories	Non- members
Luxembourg	X							X		
Macao, SAR		X							X	
Malta		X				3/		X		
Marshall Islands			X	X		X	X	X		
Mauritius			X			3/		X		
Monaco		X				X	X			X
Nauru			X	X	X	X				X
Netherlands Antilles			X			X 4/			X	
Niue			X	X		X				X
Panama			X	X		X		X		
St. Kitts and Nevis			X	X		X		X		
St. Lucia			X			X		X		
St. Vincent and Grenadines			X	X		X		X		
Samoa			X			X		X		
Seychelles			X			X		X		
Singapore	X							X		
Switzerland	X							X		
Turks and Caicos			X			X			X	
Vanuatu			X			X				
								X		
Other jurisdictions										
Alderney 5/						X			X	
Dominica				X		X		X		
Egypt								X		
Grenada						X		X		
Guatemala								X		
Indonesia					X			X		

Jurisdictions						OECD		IMF		
	FSF 1/			FATF 2/		List of Tax havens	Uncooperative Jurisdictions	Members on own rights	Dependencies and territories	Non- members
	Group I	Group II	Group III	(June 2000)	(July 2004)					
Israel				X				X		
Liberia						X	X	X		
Maldives						X		X		
Montserrat						X			X	
Myanmar					X			X		
Nigeria					X			X		
Philippines				X	X			X		
Russia				X				X		
Sark 5/						X			X	
Tonga						X		X		
Ukraine								X		
United States Virgin Islands						X			X	
Total	8	9	25	15	6	35+2 5/	5	37	17	6

Sources: FSF, FATF, IMF, and OECD.

1/ Financial Stability Forum (FSF) list of offshore financial centers as of May 2000. Group I are jurisdictions generally viewed as cooperative, with a high quality of financial supervision, which largely adhere to international standards. Group II are jurisdictions which have procedures for cooperation and supervision, but where actual performance falls below international standards. Finally, Group III jurisdictions have a low quality of supervision and are non-cooperative, with no attempt being made to adhere to international standards.

2/ FATF list of non-cooperative jurisdictions (see FATF (2004)).

3/ On June 2000, these Jurisdictions (and San Marino) made an "advance commitment" to the OECD to eliminate harmful tax practices by end-2005.

4/ These jurisdictions entered commitments after the June 2000 list.

5/ In the OECD list, Guernsey, Sark, and Alderney are all on the same list, that is they are counted collectively as one rather than one plus two as shown in this table